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SUBJECT: ISLAND INSIGHTS: MINI FTA BACKGROUNDER

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SUMMARY

2. (SBU/NF) We offer in this cable insights into four major remaining FTA issues: insurance, government procurement, car tariffs and textiles. Industry indicates that the draft insurance law is inadequate. This protected insurance sector is likely the slowest financial service to open to market forces. The Royal Court, Prime Minister's Court and Crown Prince's Court are the most sensitive entities the U.S. has requested for Government Procurement chapter coverage. However, giving in to Bahrain on these points could set an unwelcome precedent for future FTA negotiations in the GCC. On automobiles, contrary to GOB assertions, car dealers do not expect that zero tariffs on U.S. automobiles would affect market volume growth rate. Rather, consumers are more likely to shift their preferences to larger or more prestigious U.S.-made cars as they become more affordable. Post-FTA textile industry expectations have spun out of control. These must be reined in. The failure for unreasonable expectations to materialize will tarnish regionally the FTA's reputation for economic effectiveness and could hinder negotiation of subsequent FTAs in the GCC.
END SUMMARY

INSURANCE

3. (U) MOFNE officials Yousif Humood and Selma Waheedi pointed out to EconOff April 28 that a policy-level decision was needed regarding Bahrain's request for a 2-year grace period to liberalize insurance. Bahrain's Financial Services lead negotiator Abdulrahman Saif clarified for EconOff May 4 that this grace period is requested for direct non-life insurance only. Bahrain needs this time, Saif said, to transition from an established industry that was closed since its inception to an open sector. Bahrain Monetary Agency Insurance Supervision Director Tawfiq Shehab explained to EconOff May 4 that single-class insurers must be registered offshore, while onshore licenses stipulate either life or non-life. (NOTE: Shehab said that there are currently 9 or 10 local insurers, plus 9 branches onshore, while there are 80 offshore companies. END NOTE). Onshore non-life insurers are currently required to offer all classes of non-life insurance, including compensatory auto insurance at government pre-set rates, Shehab continued. Bahrain is in the process of formulating a new insurance law as part of the transition of the industry from the Ministry of Commerce to the Bahrain Monetary Agency, Saif added. PriceWaterhouseCoopers London has already prepared three consultative papers to address the regulatory regime, which is scheduled to begin implementation in 2005. However, Saif said, the underlying reason for Bahrain's request for a two year transition phase is that the BMA needs to train regulators and establish procedures to enforce the new law.

4. (SBU) However, ALICO has alerted post to another insurance-related concern. ALICO-AIG Bahrain Group Managing Director Ghaleb Hammoudi shared with PolEconOff April 28 e-mail correspondence from ALICO Gulf COO Fadi Chammas to Bahrain Monetary Agency Executive Director of Financial Institutions Supervision Anwar Al Sadah, in which Chammas expressed his disappointment with Bahrain's draft insurance law. Hammoudi elaborated to EconOff May 4 that the draft law does not allow for commission-based sales agents, but requires instead a European-style employer-employee relationship. ALICO-AIG would be forced to change their sales system to one they consider less effective and less motivating. The change, he said, would also open the company up to employee litigation and subject the company to Bahrainization quotas. Hammoudi anticipated that, as a

result of the new law, ALICO would experience losses, not growth, and would likely shut its doors to its current 12,000 client families in Bahrain after two to three years. Hammoudi described the proposed legal framework as "a protectionist, sentimental, spoon-feeding employment policy," adding that Chammas had characterized the draft law as "even worse than the existing law." In his e-mail, Chammas wrote that as a result, Insurance and Reinsurance companies are racing to establish operations in Dubai.

GOVERNMENT PROCUREMENT

15. (U) Two outstanding government procurement issues are GCC preferences and coverage. Ministry of Finance and National Economy (MOFNE) Director of Economic Affairs Yousif Humood and MOFNE Senior Economist Selma Waheedi assured EconOff April 28 that GCC preference in government procurement is a non-issue. This preference ends at the beginning of 2005 per WTO to meet national treatment requirements. Furthermore, at the upcoming mid-May GCC summit Bahrain intends to raise the prospect of ending preferences before the end of the year.

16. (U) On coverage, MOFNE's Humood and Waheedi stressed to EconOff April 28 that Bahrain would have great difficulty in accepting the additional government entities the United States has requested for inclusion. Unsurprisingly, they cited the Amiri (Royal) court, the Prime Minister's Court, and the Crown Prince's Court as political non-starters. The officials included the Bahrain Monetary Agency (BMA), Bahrain's central bank, among the most problematic because of the agency's "need for autonomy," they said.

MARKET ACCESS: CARS

17. (SBU) The Government of Bahrain's stock answer for not including automobiles--five percent of U.S. exports to Bahrain in 2003--in its duty-free market access offer is that the resultant five percent reduction in cost to consumers would cause a run on cars, yielding increased traffic congestion and pollution problems. However, car buyers in Bahrain are a price sensitive population, Director of Zayani Motors Nawaf Zayani, whose family's company represents Chrysler, Mitsubishi, BMW, Range Rover and MG in Bahrain, told Econoff May 3. At the same time, cars are a high-prestige item, and families will spend up to fifty percent of their monthly income on a car, he added. Almoayed Motors (Ford, Lincoln, Mercury) General Manager Sunil George told EconOff May 3 that he would not expect the total market size to change as a result of reduced tariffs on U.S. automobiles; rather he expects a shift to more expensive models or from Japanese or European makes to U.S. cars. Jeff Thomas, National Motor Company General Manager (Chevrolet, Cadillac, GMC, Honda) noted May 3 to EconFSN that as a result of the soft dollar, NMC had seen a noticeable shift from Honda purchases to their more competitively priced American brands. Mannai Motors owner Talal Mannai (Saab, Opel) also told EconFSN that U.S. vehicles already have a built-in price advantage over cars valued in Euros.

18. (SBU) Car dealers in Bahrain appreciate the difference between an American brand car and a car made in America. Almoayed Motors General Manager Sunil George told EconOff May 3 that more than fifty percent of their fleet--Ford, Lincoln and Mercury--are produced in Europe. Small "American" cars, which represent Almoayed's high-volume sales in Bahrain, tend to be produced in Europe (Ford) and small GM cars for the region are produced in Korea. Only Almoayed's large, luxury vehicles, such as the Lincoln Towncar or Crown Victoria, are produced in America, George added. Conversely, Nawaf Zayani noted that certain "non-American" makes stood to benefit from a reduction in tariffs on U.S. cars. For example, popular models such as Toyota Camry, Honda Accord and the BMW X-5, are made in America.

TEXTILES: MANAGING EXPECTATIONS

19. (U) As if reading from the same script, representatives from the Ministry of Industry, Ministry of Labor, the National Assembly and the business community repeat to anyone who will listen the message that the FTA is the panacea that will rescue and reinvigorate Bahrain's textile/garment industry. The rapidly spreading urban legend maintains that FTA's zero tariffs and TPLs will not only compensate for Bahrain's higher costs of production--including highest labor costs in the region--to make Bahrain's products highly competitive in the post-quota marketplace, but will even cause the sector to grow and generate new jobs. Members of the Bahrain Chamber of Commerce and Industry Textiles Committee (Garment Section) expect that companies that closed because they were uncompetitive would be revived and would

thrive in a post-FTA world. That Bahrain's garment manufacturers tend to use third-country cloth that would not meet yarn-forward tests does not enter into the equation. Instead, there is an unfounded expectation that FTA will make a powerhouse out of Bahrain's garment industry and in so doing will magically free Bahrain of its unemployment-related social ills. Emboffs have heard these same fables repeated to congressional staffers, FTA negotiators, and in private meetings.

10. (U) EconOff often discussed with MOFNE officials the need for public outreach to explain what FTA can and cannot do and to rein in unreasonable expectations. May 3, MOFNE Director of Economic Relations Yousif Humood addressed the Bahrain Chamber of Commerce and Industry. EconFSN, who attended the open session, reported that even after this forum, the public still harbors many misconceptions and questions about FTA.

COMMENT

11. (SBU/NF) On insurance, U.S. companies' perspectives and their interests in the region indicate that we need to push harder for an agency model in Bahrain's insurance law as well as quicker transition to opening the sector. Post firmly believes that backing down on our Government Procurement entities list is inadvisable because the optics are atrocious and would ultimately have implications for future Gulf FTAs. Based on our survey, anecdotal evidence at the microeconomic level does not support the GOB Market Access stance on cars. We recommend sustaining our position. Textile hysteria needs to be calmed, both to conclude the chapter and to give FTA implementation a reasonable chance for public perception of economic success. END COMMENT.
FORD